

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Federal-State Joint Conference)	WC Docket No. 02-269
On Accounting Issues)	

REPLY COMMENTS OF SBC COMMUNICATIONS INC.

SBC Communications Inc., for itself and its wholly owned affiliates¹ (“SBC”), submits the following reply comments in response to the Public Notice released in the above-captioned proceeding.²

I. INTRODUCTION AND SUMMARY

The Comments filed in this proceeding demonstrate that the Commission’s accounting and reporting requirements are no longer necessary in the public interest and that streamlining the current regulations for price cap carriers is mandated by Section 11 of the Communications Act of 1934, as amended (“the Act”). It’s not surprising that AT&T and Worldcom want to see the ILECs remain shackled by the outdated Part 32 accounting rules and ARMIS reporting requirements while they continue to gain access to as much information about the large ILECs as possible without having to provide such information themselves. But, their arguments for the continued accounting regulation of one class of carriers have no merit in this competitive environment since they fail to demonstrate a valid federal regulatory purpose to support the continued use of these rules. On the other hand, comments to the contrary overwhelmingly illustrated that the Commission can achieve its desired level of regulatory oversight through generally accepted accounting principles (“GAAP”). Consequently, the Joint Conference should

¹ SBC Communications Inc. (“SBC”) files these Comments on behalf of its subsidiaries, Southwestern Bell Telephone, L.P. (“SWBT”), Pacific Bell, Nevada Bell, Ameritech Operating Companies, and the Southern New England Telephone Company.

² *Federal-State Joint Conference on Accounting Issues*, Request for Comment, DA 02-3449, at 1 (rel. Dec. 12, 2002) (“*Joint Conference Request for Comment*”).

recommend that the Commission relieve the incumbent LECs from the substantial administrative and financial burdens imposed by the current regulatory accounting rules and recommend that the Commission continue streamlining these accounting regulations and reporting requirements by allowing price cap carriers to transition to GAAP for regulatory reporting.³

II. FEDERAL ACCOUNTING AND REPORTING RULES MUST BE NECESSARY FOR A FEDERAL REGULATORY PURPOSE.

As discussed in the Comments, the Part 32 accounting and ARMIS reporting rules were developed as tools for rate of return regulation and other cost-plus methods of regulating rates.⁴ However, the Commission's accounting and reporting rules have not kept pace with the evolution of rate-based regulation and are consequently administered without regard for the necessity of the rules. The largest ILECs are subject to pure price caps but remain the only ILECs that are required to follow the most stringent and detailed accounting and reporting requirements.⁵ Meanwhile, these burdensome and detailed accounting and reporting requirements do not apply to the small and mid-sized ILECs although many of them remain subject to rate of return regulation. Since rate of return regulation can be achieved without the Commission's accounting and reporting rules, it stands to reason that these rules are unnecessary for price cap carriers as well.⁶

³ As SBC stated in its comments, the FCC need not duplicate and possibly contravene the significant accounting reform efforts currently underway. Rather, the FCC should defer to Congress and other government agencies (e.g., the Securities and Exchange Commission) that have the responsibility to adopt and implement accounting reforms that will result in more accurate, reliable and consistent accounting information for all public companies. *See* SBC Comments at 12.

⁴ BellSouth Comments at 12; SBC Comments at 4-5; USTA Comments at 8 -9; Verizon Comments at 13.

⁵ For example, only the BOCs are subject to the more detailed Class A level of reporting, must file all ARMIS reports, and must meet the cost allocation manual (CAM) filing requirement and the associated biennial attestation requirement

⁶ While the Florida Commission advocates for new accounting requirements, it acknowledges that it no longer requires large ILECs to file financial reports to the FPSC since these companies are "no longer rate based regulated." Florida Comments at 3.

The Commission staff previously recognized that effective competition eliminates the need for accounting regulations. In its Staff Report to the Commission, the staff acknowledged that Part 32 rules were established to deter cross-subsidization in a “largely” “rate of return environment” and recognized that “competitive developments during the 1990s . . . may impose more burdensome information requirements on incumbent LECs than needed in light of the changing competitive landscape.”⁷ Competition has increased dramatically over the last three years: CLECs have increased the number of business lines served three-fold and increased the number of facilities-based residential lines served thirty-fold.⁸ These antiquated one-sided regulations distort competition and should not be allowed to continue.⁹

AT&T claims that ARMIS and regulatory accounting is necessary at the federal level to prevent “anticompetitive abuses of market power”¹⁰ and cites to its *Petition for Reform of ILEC Special Access Rates* to illustrate that ARMIS reporting protects consumers and measures competition in the market place.¹¹ Just because AT&T used ARMIS data in this proceeding, doesn’t mean that it was a proper use of the data. As SBC and other ILECs discussed in that docket, AT&T’s use of ARMIS data to support this proposition was misplaced because the Commission has already recognized that “the collection of rate of return data on an access category or rate element level is improper and unnecessary for price cap LECs.”¹²

⁷ 2000 Biennial Regulatory Review, CC Docket No. 00-175, Initial Staff Report, 15 FCC Rcd 21084 (2000).

⁸ See UNE Fact Report 2002, Summary of Competitive Entry in SBC Regions – Comments of SBC Communications Inc., CC Docket 01-338, p. 1-5 (April 5, 2002), filed as Attachment A to SBC Comments.

⁹ See SBC Comments at 5-6.

¹⁰ AT&T Comments at 5.

¹¹ *Id.* at 6.

¹² See Opposition of SBC Communications Inc., *Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM No. 10593, at 17-23 (filed December 2, 2002) (citing *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6833 (1990).

AT&T also claims that regulatory commissions need accounting and reporting as well as audits “to develop pro-competitive policies and to assess whether those policies are working,” “to ensure that [ILECs] are charging ‘just and reasonable’ rates for interstate services” and “to implement price caps.”¹³ The FCC doesn’t need accounting data to assess whether its pro-competitive policies are working. To the contrary, to the extent there is any lack of evidence in that regard, it is because the FCC does not obtain sufficient information from other segments of the industry, specifically CLECs, wireless providers, and cable companies, about the facilities they have deployed, the services they are offering and the number of lines they have won. As the Commission itself has noted, “the reports of at least some CLECs are not consistent” with [the Commission’s] directions, and, as a result, “there may be some need for further clarification and adjustment of the reporting system.”¹⁴

In addition, the Commission’s recent actions demonstrate that AT&T’s assertions are wrong. For example, the FCC has initiated and completed two of three planned phases of its *Comprehensive Review of the Accounting Requirements*, in which it has streamlined many of its accounting and reporting requirements, and has also completed an agency reorganization in which the Accounting Safeguards Division (previously known as the Accounting and Audit Division) has been disbanded. The reorganized FCC is now designed to effectuate strong enforcement of the local competition provisions of the Act through mechanisms such as the complaint process and dispute resolution as well as investigations rather than continuing unnecessary and burdensome regulatory oversight via accounting and reporting requirements.

Some parties erroneously contend that Part 32 accounting and ARMIS reports are necessary to set rates for unbundled network elements.¹⁵ As explained in SBC’s Comments,

¹³ AT&T Comments at 5-7.

¹⁴ *FCC Local Competition Report*, Feb. 2002 ed. at 1-2, n.3; *See also* UNE Fact Report 2002, Appendix A to SBC Comments.

¹⁵ AT&T Comments at 12-13; NASUCA Comments at 13-14; and WorldCom Comments at 5.

ARMIS costs are not the basis for UNE rates; the key drivers for cost studies are forward looking costs, including depreciation, cost of capital and fill factors.¹⁶

Furthermore, it is clearly not necessary to subject large ILECs to the more rigorous accounting and reporting requirements “to administer the Commission’s universal service program” as AT&T suggests.¹⁷ Since most ILECs are non-rural LECs, they are only eligible to receive high cost universal service support based on a forward looking economic cost model.¹⁸ However, many of these non-rural ILECs are classified as small- or mid-sized ILECs under the Commission’s accounting rules and consequently are not subject to the more burdensome accounting and reporting requirements as the large ILECs. This results in unequal treatment of large ILECs that are subject to the same method for calculating high cost universal service support as many small- and mid-sized ILECs. Therefore, it is certainly an overstatement to suggest that the Part 32 accounting rules and ARMIS reporting requirements are “necessary” to administer universal service.

With respect to adding the accounts proposed by the states in the Phase II proceeding, the Florida Public Service Commission (“FPSC”) cites broad regulatory interests “to maintain an up-to-date accounting system,” “to continue to understand the nature of the ILECs’ investment and ensure that prices are reflective of their actual costs,” “to monitor issues,” and “to aid states in administering the prices of [UNE and interconnection].”¹⁹ However, the FPSC fails to demonstrate how these interests are necessary to justify the substantial burden that would be imposed on incumbents LECs. Such overly broad and unsupported interests are simply not justified in an increasingly competitive marketplace.

¹⁶ SBC Comments at 7; *See also* Verizon Comments at 15.

¹⁷ AT&T Comments at 6.

¹⁸ This method requires far less detailed accounting information than rural LECs that receive high cost universal service support under the embedded cost mechanism, but are not subject to many of the FCC's burdensome accounting and reporting requirements.

¹⁹ FPSC Comments at 2-3.

Likewise, AT&T's proposal to maintain and strengthen the existing affiliate transactions rules must be rejected. AT&T claims that the Commission's initial section 272 audit of SBC "have uncovered substantial misconduct and violations of Section 272."²⁰ Yet, the only evidence that AT&T conjures up to support this claim is AT&T's *own pleadings*.²¹ In fact, the audit reports show no evidence of either discrimination or cross-subsidization and to date, no regulatory body, federal or state, has found SBC in violation of Section 272 as AT&T claims.

It is obvious that AT&T and other commentors twist the facts from several proceedings or cite broad regulatory interests to concoct a "federal need" for the Part 32 accounting and ARMIS requirements. At best, these scenarios show that Part 32 and ARMIS reporting may be "useful." But, the required standard for continuing a federal regulation is "necessity," not usefulness.²² More importantly, no commentor has demonstrated why GAAP is insufficient for regulatory accounting and reporting purposes for ILECs.²³

III. ADDITIONAL AUDITS ARE NOT NECESSARY TO ENSURE ACCURACY OF ACCOUNTING INFORMATION

Although as a general proposition, it is entirely reasonable for the Commission to ensure compliance with its rules, the costs of the methods used must always be weighed against the benefits. There is little, if any, reason for the Commission to conduct audits of compliance with regulatory accounting requirements for the simple reason that there is little reason for regulatory accounting *at all*. At one time, audits may have served a purpose. However, with the onset of price cap regulation and increasing competition, there is no justifiable basis to retain the use of audits as an incentive for compliance. In this environment, government oversight through

²⁰ AT&T Comments at 19.

²¹ See AT&T Comments at n. 18.

²² See SBC Comments at 3.

²³ In fact, even under GAAP, the FCC and state regulatory commissions can, and have, participated in the consideration of new accounting standards promulgated by standard setting bodies (e.g., FASB and AICPA). For years regulatory agencies have provided input addressing their concerns regarding the potential impact of the proposed standards on regulated companies subject to their jurisdiction. To this end, specific accounting standards have even been adopted that apply solely to regulated industries.

burdensome audits of one sector of a competitive industry, large incumbent LECs, is unnecessary and creates market distortions and inefficiencies rather than correcting a perceived market failure.²⁴

In fact, far from conducting more audits, the FCC should eliminate its Cost Allocation Manual (CAM) audit all together. Although the FCC has required annual CAM audits of large incumbent LECs for close to fifteen years, the CAM audit no longer serves any useful purpose and merely imposes costs without any countervailing benefits. More specifically, both competition and the replacement of cost-based regulation with price caps has obviated any need in this regard. The CAMs are publicly filed at the FCC and any interested party may access the CAMs, file comments in the annual CAM proceeding,²⁵ or file a complaint with the FCC or state regulatory commission alleging anticompetitive conduct resulting from discrimination or the misallocation of costs.²⁶ Consistent with the FCC's regulatory policy shift away from conducting burdensome and costly audits to relying on market-based enforcement mechanisms, the Joint Conference should recommend the elimination of the CAM audit requirement.

AT&T refers to a biased audit report, conducted on behalf of the Office of Ratepayer Advocates, as ammunition to support its contention that the Commission should increase the number and frequency of audits.²⁷ Once again, AT&T misstates the facts to support its goal of

²⁴ SBC already spends extraordinary resources on audits including the FCC-required CAM audit and the FCC's subsequent reviews of the CAM audit, the independent audit of SBC's SEC reported financial statements, the biennial 272 audits, numerous state PUC commissioned audits covering numerous issues such as CAM and affiliate transactions issues, financial reporting and accounting, infrastructure investment, service quality reporting, etc. In addition, SBC maintains a vigorous schedule of internal audits on various financial and operational issues. Additional audits would only be duplicative and wasteful.

²⁵ Each year, the FCC receives virtually no comments on any ILECs CAM filings, demonstrating the decreasing reliance on CAM audits and lack of concern with cost misallocations.

²⁶ For example, certain cable operators filed a Section 208 Complaint against BellSouth alleging misallocation of joint and common costs between its telephony and cable services in a manner that violates the Commission's cost allocation rules. *See Tennessee Cable Telecommunications Association, et al. v. BellSouth Telecommunications, Inc., Complaint*, File No. E-97-10 (filed January 27, 1997).

²⁷ AT&T Comments at 11.

keeping the ILECs burdened with unnecessary regulation. The Pacific Bell review referred to by AT&T was performed by Overland Consulting (“Overland”) on behalf of the Office of Ratepayer Advocates and does not represent any finding by the California Public Utilities Commission. Overland’s audit report lacks validity since Overland is not licensed by a state board of accountancy and thus, is not a certified public accountant. Furthermore, Overland did not perform the audit in accordance with Generally Accepted Accounting Standards (“GAAS”). Notwithstanding the foregoing and assuming Overland’s accusations had merit, Overland itself admitted that its findings were immaterial in stating that “[w]e did not conclude that internal control weaknesses affecting affiliate service transactions had a material impact on Pacific’s CPUC-basis financial results during the years 1997 through 1999.”²⁸

²⁸ “REGULATORY AUDIT OF PACIFIC BELL FOR THE YEARS 1997, 1998, 1999”, prepared for the California Public Utilities Commission by Overland Consulting, at p. 12-3, (February 21, 2002). The record also reflects that the \$400 million royalty fee, also referred to by AT&T, is properly recorded below-the-line and did not impact the regulated earnings of Pacific Bell.

IV. CONCLUSION.

The Joint Conference should recommend that the Commission continue streamlining its accounting and ARMIS reporting requirements consistent with Section 11 and Congress' goal of creating pro-competitive deregulatory national policies.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Regina Ragucci, do hereby certify that on this 19th day of February 2003, Reply Comments of SBC Communications Inc. in WC Docket No. 02-269, was served first class mail - pre-paid postage to the parties attached.

/s/ Regina Ragucci

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